At the Friday close the market consensus was that the Federal Reserve would cut short-term interest rates by 50 - 75 basis points in 2019, with another 25 basis point cut in 2020. We think this is nuts.

The US economy doesn’t need rate cuts. At present, we are projecting that real GDP is growing at about a 1.5% pace in the second quarter. That’s slower than the recent trend but largely held down by a return to a more normal pace of inventory accumulation, which is a temporary phenomenon. Excluding inventories, real GDP is growing at a 2.5 – 3.0% annual rate.

Some analysts and investors are worried about the relatively slow pace of payroll growth in May, which came in at 75,000. But there’s nothing awful about this pace of job creation. The bond market is convinced this means rate cuts are necessary to avert a recession; but the stock market has surged, suggesting it’s not worried about growth.

Since the business-cycle peak in 2001, the labor force has grown 0.7% per year. At that trend, we need about 90,000 jobs per month to keep the unemployment rate steady, not far from where we were in May. So rather than seeing the May payroll gain as a reason to cry, we should instead have seen the prior trend as a reason to celebrate. In fact, while low unemployment rates may lead to smaller monthly gains in jobs, we’re not convinced it will anytime soon.

Nor does potentially slower job growth mean the economy has to grow more slowly, as well. Productivity growth has picked up in the past couple of years due to deregulation and lower taxes on corporate profits and investment. As a result, the economy’s growth potential has improved, and a smaller share of growth can come from increasing the number of hours worked.

This weekend brought good news: that the Trump Administration and Mexico reached a deal to avert higher tariffs. As we explained in last week’s MMO, a potential trade war with Mexico on immigration was a legitimate concern and we are very relieved the threat has passed. We also hope the G20 meeting later this month leads to a trade deal with China. If so, this news along with better economic data, should propel longer-term Treasury yields significantly higher. Risk appetites in the financial sector should recover.

As a result, we expect the Fed to “punt” at the June meeting, leaving rates unchanged, although the new “dot plot” will likely show some policymakers projecting rate cuts later this year. Our view is that better news will cut the rate reductions off at the pass, and the Fed will end up leaving rates unchanged this year.

Does anyone seriously believe short-term rates at 2.375% are an obstacle to economic growth, that it is preventing some entrepreneur from embarking on some venture or a firm from putting some equipment into place?

Instead, we think policymakers who are interested in promoting economic growth would be better served by turning the focus toward government spending. In the background of all the recent news, the long-term fiscal problems embedded into Social Security, Medicare, and Medicaid keep getting worse.

The federal government spent 20.3% of GDP in the four quarters ending in March, far higher than the 17.7% it spent in 2000. Finding ways to reduce spending now and in the future would boost our growth potential even higher.